

## Internal Revenue Service

Department of the Treasury  
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### LEGEND

Taxpayer =

State =

Joint Powers Act =

Trust =

Dear :

### FACTS

Taxpayer is an entity created pursuant to the Joint Powers Act of State. Its purpose is to provide a pooled fund in which its members can invest their available money. Members of Taxpayer are cities, city utilities and counties, all of which are political subdivisions or instrumentalities of State the income of which is excluded from gross income by § 115(1) of the Internal Revenue Code (the Code). Taxpayer is governed by a board of trustees elected annually by its members.

Taxpayer created Trust to help the members of Taxpayer provide post-retirement health benefits for their employees under their respective retiree health plans. A member of Taxpayer may become a participating employer in Trust by entering into a participation agreement with the trustees of Trust. Under the terms of the amended trust agreement, only an entity that is a state, a political subdivision of a state or an entity the income of

which is excluded from gross income under § 115(1) of the Code may become a participating employer in Trust. Trust is governed by a board of trustees. Pursuant to the original trust agreement, Taxpayer's board of trustees served as Trust's initial trustees. However, the trust agreement has been amended to provide that the participating employers shall select successor trustees and can remove and replace any trustee by a majority vote.

Trust's income consists of contributions from participating employers and investment income. Each participating employer has a separate account established under Trust. Assets allocable to such separate account will include all contributions received by the trustee on behalf of the participating employer together with the income and earnings from such contributions. Each participating employer has a separate post-retirement health benefits plan. The assets of Trust are used exclusively to provide post-employment health benefits to former employees of participating employers (and their dependents) in accordance with each participating employer's plan and to defray the reasonable expenses associated with providing benefits. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services.

As originally written, the trust agreement could be amended or terminated by Taxpayer. The trust agreement has been amended to provide that it can only be amended or terminated by its trustees. Upon termination of the trust agreement and satisfaction of all of Trust's liabilities, any amount remaining will be returned to the participating employers for the purpose of satisfying their plan obligations. In no case will the assets of Trust be distributed to an entity that is not a participating employer in Trust.

## LAW & ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to

§ 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a Federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of its participating employers, each of which is a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115(1) of the Code. Providing health benefits to current and former government employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to its participating employers. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of Trust satisfies an obligation the participating employers have assumed with respect to providing health benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information provided and representations made by Trust, we conclude that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed as to the classification of Trust as a trust for Federal tax purposes. Further, no opinion is expressed concerning Federal tax consequences under any other provision of the Code other than those specifically stated herein. In particular, no representation is made that contributions to participating employers' plans or payments to employees, former employees, retirees, spouses or dependents from participating employers' plans will be tax-free. The Trust has obtained a ruling concerning only the Federal tax treatment of Trust's income. That ruling may not be cited or relied upon concerning any matter relating to the taxation of benefits under participating employers' plans. The Federal income tax consequences to employees, former employees, retirees, spouses and dependents depend solely on the term and operation of the plans.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k) (3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Harry Beker  
Chief, Health and Welfare Branch  
Office of Division Counsel/Associate  
Chief Counsel (Tax Exempt & Government  
Entities)